



D.C. Tax Revision Commission

MEETING MINUTES

Subject: D.C. Tax Revision Commission Meeting
Date: Dec. 3, 2013
Time: 3:00 p.m. to 6:00 p.m.
Location: Room W250 1101 4th Street, S.W. Washington, D.C. 20024

Members Present:

Anthony Williams (Commission Chair)
Teresa Hinze
Ed Lazere
David Brunori
Pauline Schneider
Kim Rueben
Stefan Tucker
Nicola Whiteman
Mark Ein
Fitzroy Lee

Staff:

Ashley Lee
Gerry Widdicombe
Steven Rosenthal
Richard C. Auxier
Elisha Gaston

I. Call to Order (Anthony Williams)

Mr. Anthony Williams, chair of the D.C. Tax Revision Commission (the “Commission”), called the meeting to order at 3:13 p.m., and began by thanking the Office of the Chief Financial Officer (OCFO), the Office of Revenue Analysis (ORA), and the Office of Tax and Revenue (OTR) for their exceptional contributions to the Commission’s efforts. He announced that electronic copies of the materials for the meeting were available on the Commission’s website, and invited members to contact Ms. Ashley Lee for hard copies. Mr. Williams notified those present that the Commission’s final public meeting would be held on Dec. 9, from 1:30 p.m. to 3:30 p.m., in the same room.

II. Discussion of Commission Schedule and Deliberation Process

Mr. Williams announced that Mr. Richard Auxier and Mr. Steven Rosenthal would lead the Commission’s deliberations for the day, in an effort to determine what the general consensus of the Commission is on each of the options being considered.

Mr. Rosenthal directed the Commission to examine the draft chairman’s mark proposed by Mr. Williams. The mark included two tax reform packages—with accompanying revenue estimates—for the Commission’s consideration.

III. Review of the Draft Chairman’s Mark

Mr. Rosenthal started the deliberations by discussing the sales tax package. He remarked that one of the recommendations is to expand the sales tax to services as suggested by Professor William Fox. The next part of the sales tax package was to add a use tax line to the individual income tax. Another recommendation was unify the taxation of tobacco produces.

Mr. Rosenthal then noted the recommendation to raise the general sales tax rate to 6%. He added that Virginia recently raised its rate to 6%, and that it would make sense to match neighboring jurisdictions if the additional revenue could be used to fund other methods of tax relief.

Mr. Rosenthal moved on to his discussion of the estate tax, noting there seemed to be a consensus to match the federal formula and raise the threshold to \$5.25 million.

Moving on to the business taxes, Mr. Rosenthal noted that one recommendation is to reduce the business franchise tax rate from 9.975% to 7.75% or 8.25%. He added that the Commission had discussed reducing business tax rates as a signal to the business community. Mr. Rosenthal remarked that the revenue difference between 8.25% and 7.75% is relatively modest.

Mr. Rosenthal moved on the recommendation to exempt passive investment vehicles from the unincorporated business franchise tax. He added that ORA requested additional time for making a revenue estimate

Mr. Rosenthal praised Commissioner Fitzroy Lee's office for providing the Commission with estimates for its 63 options in short order. He noted, however, that a final package still must be subject to a four-year budget window as required by the D.C. Council. He added that the Commission still needs to examine the interaction of its proposals in a final package. For example,

Mr. Rosenthal said that another option that the Commission would discuss was the option to begin using a single weighted sales factor formula, and shifting from the current double weighted sales factor.

Mr. Rosenthal moved on to the commercial property tax. He remarked that D.C. has exceptionally high commercial property tax rates, and that the option being considered would reduce the tax by a few cents. This small change was relatively expensive as every penny of reduction costs approximately \$6 million in revenue. He said that there is commercial property tax cut in the generous package but not in the revenue-neutral package.

Mr. Rosenthal explained that this package would ultimately include tax administration recommendations.

After Ms. Teresa Hinze noted one option had been skipped, Mr. Rosenthal backtracked and described the option to levy a local services fee on employers. He said the fee would require each employer to pay \$25 per employee on a quarterly basis. He offered to describe the definition of employee under this provision to the extent the Commission was interested.

He added that this service fee would only apply to employers with five or more employees, and that roughly one third of the employers in D.C. have fewer than five employees. Putting this into perspective, Mr. Rosenthal remarked that 90% of employees in the District work for employers with more than five employees, and that this reality could help the Commission to effectively exclude local businesses while helping to bring nonprofits into the fold. He noted that of the choices considered by the Commission for broadening the base to include nonprofits, the Chairman settled on a services fee.

Mr. Williams remarked that it seemed that there was a consensus on this issue.

Mr. David Brunori commented that those with five employees will soon have four, adding that "if you tax something people try to avoid it."

Mr. Widdicombe asked that Commissioners wait till the deliberation part of the meeting schedule to share their comments.

Returning to the individual income tax, Mr. Rosenthal noted that he would discuss the package since Ms. Kim Reuben, who assisted with its assembly, had not yet arrived. He noted that the Commission has crafted this package separately because it is complicated and multidimensional. He said that Ms. Reuben and the income tax subcommittee worked with the many moving pieces, along with the help of ORA, to generate dozens of scenarios, and ultimately develop a package that fits with the Commission's goals.

One recommendation was conforming to the federal filing options—D.C. has eight filing options while the federal government has five. Another recommendation moves D.C. from one bracket to a two-bracket system. Having different brackets for single filers and married-joint filers address the "marriage penalty."

Another recommendation was creating a new rate tax bracket between \$40,001 and \$80,000 of taxable income and taxing it at 6.5%. For single people the new bracket would be for taxable income between \$40,001 and \$60,000. Mr. Rosenthal also noted under the proposal the 8.95% rate would now start lower for singles, at \$200,000, as opposed to \$350,000 for married couples.

Mr. Rosenthal remarked that the bottom line is that there may yet be a small increase for some high-income singles but that most who earn around \$350,000 or below would see a tax cut. He directed Commissioners to refer to the tables in their memos that break down the effects of the tax changes.

Mr. Rosenthal also explained that the higher rates kick in at about the time that people start itemizing deductions, and that this is intentional because itemizing deductions often leads to significantly lowered liability.

Mr. Rosenthal said that the other options include increasing the Earned Income Tax Credit (EITC) benefit for childless workers. He also explained that the package also eliminates some tax expenditures. He added that subcommittee recommended eliminating the low income credit, since it is unnecessary if the standard deduction and personal exemption are raised to the federal levels.

Mr. Ed Lazere asked for one minute to address the issue of the filing statuses. He said that D.C. is fairly unique, in that it has just one bracket. He said that creating two brackets had led to a debate about what the top marginal rate should be for these two brackets. He remarked that when you take into account the other changes, singles see little or no change in their taxes even though their top marginal rate would start earlier than for married-joint filers.

Ms. Reuben said that in order to raise some money, her subcommittee played around with how itemized deductions and personal exemptions are phased out. She noted that if they start at the same place, this would lead to a high marginal change in tax liability.

Mr. Rosenthal noted that the subcommittee recommended extending the top 8.95% rate permanently, but that one package allows that rate to drop to 8.5% in 2016 (as is current law).

Mr. Williams announced that the Commission would now discuss of the tax packages.

Mr. Ein asked who bears the majority of the burden for the phase outs of itemized deductions and personal exemptions.

Mr. Rosenthal said that all taxpayers are afforded a choice of a standard deduction or an itemized deduction, and people generally start to itemize at around \$75,000. Shifting the conversation to the personal exemption, he noted that D.C. has a relatively modest personal exemption that would be increased to the federal level.

Ms. Reuben added that the personal exemption phases out at \$250,000 and the itemized deduction phases out at \$200,000.

Mr. Rosenthal said that people at the higher income ranges would not get the benefit of the package that is aimed at lower-income residents.

Ms. Reuben said that for incomes between \$350,000 and \$500,000, taxes would go up by about \$500 dollars, and for \$500,000 to \$1 million the increase would be \$1,233, as a result of the phase outs.

Mr. Williams asked commissioners to share their comments about some of the other options.

Mr. Lazere asked whether Mr. Williams was hoping that the Commission wants to recommend one or two packages—one revenue neutral and one with more tax relief.

Mr. Williams commented that he would recommend putting forward both, though the question was not yet decided.

Mr. Lazere criticized the label of the bigger package, called “investing surplus,” as inaccurate, and noted that there is no surplus. He added that the larger package would not be funded and could not be implemented. He argued the Commission should not be thinking that there is a surplus of revenue to invest.

Mr. Widdicombe commented that the costs of this larger package could also be phased in over time.

Ms. Reuben said that she is more in favor of giving the large package by a more accurate label.

Ms. Hinze said that although Mr. Williams spoke at the beginning about investing, she has concerns about the larger package.

Mr. Ein noted that the Commission is charged with recommending a tax system that will help the city over the next decade. He said one thing missing from the package is recommendations to make D.C. a good place for people of all tax brackets to locate. He added that Mr. Brunori mentioned in the beginning that the Commission should focus on broadening the tax base and lowering the rates.

Ms. Reuben said that she supports the option that includes an increase of about \$500 for people making over \$1 million, especially since it also includes tax cuts for incomes all the way up to \$350,000. She said that it is important to recognize that the 8.5% rate starts really early, and that solving this by creating a new middle-income bracket costs money. She asked where this money will come from if not from the top earners.

Mr. Ein said that there is agreement on lower rates in the middle, and mentioned that the Commission. He added that if you look, three quarters of people with higher income are paying higher taxes in the proposal. He said the Commission should make changes without going to the wealthy for more money. He asked Commissioners whether it should send a message that every time we need more money, we go to same people, or whether it should instead, keep the rates same and make it sustainable.

Mr. Lazere noted that there was a poll in 2011 after Mayor Vincent Gray proposed an increase in rate for people over \$350,000, and the results showed that 89% of people with income over \$200,000 approved of the tax hike. He added that the Commission did not hear a single person testify that the top rate is too high.

Mr. Ein asked rhetorically what Mr. Lazere expected a witness to come in and say. He added that the assumption was that we would keep the current law as is.

Mr. Lazere remarked that the reality is that property tax rates have been cut for all residents, and the income tax rate was cut in 1998. He added that the notion that D.C. keeps going after high income people for more and more is not accurate.

Mr. Ein said that the reality is that companies start in D.C., and get to a certain size, and then they move. He remarked that wealthy people move to D.C. when they are single, but leave as they earn more money and start a family. He said that the goal is to make it so that these people don't want to move out when they start making money. He reiterated that the Commission was supposed to aim for a balance that would include broadening the base and lowering the rates.

Mr. Williams asked whether Mr. Ein would prefer keeping a lower top individual income tax rate or the lower business tax rates the Commission had previously discussed.

Mr. Ein said that he is not sure that the Commission needs to go to 7.75% on the business franchise tax. He added that the Commission could send a signal just by matching Maryland's 8.25% rate. He also said if revenue is a concern he still prefers increasing taxes on hotels and restaurants that can be exported but that he is aware of Mr. Williams' opposition.

Mr. Tucker apologized for disagreeing, and remarked that the tax increase was only about \$500, which is deductible on federal returns. He noted that the Commission has accomplished its objective of broadening the base, and has substantially lowered the business franchise tax as well as the unincorporated business franchise tax. He added that the Commission has also lowered the estate tax, which makes D.C. more competitive, and helped the middle class with a rate change for incomes between \$40,000 and \$80,000. Mr. Tucker said that this was overall a great package, even though not all Commissioners agree on each of the elements.

Mr. Ein said that the Commission should remain aware that there is a signaling impact to this, and that an increase to a particular group of people with certain amounts of money sends a discouraging signal to those people. He added that the majority of wealthy people who work in D.C. live right outside its borders in Virginia.

Mr. Tucker said that many people leave for reasons not related to taxes.

Mr. Williams said that the Commission could discuss some ideas for keeping the top income tax rate at 8.5% and getting revenue from other sources.

Mr. Lazere said that the Commission needs to decide whether or not it is appropriate to keep the top rate at 8.95% in whichever package it recommends.

Mr. Williams said that the Commission will vote on this next week, and asked which Commissioners hadn't had a chance to speak.

Ms. Nicola Whiteman remarked that she is not discouraged by the total cost of the bold package, because part of the Commission's job is to make bold suggestions. She added that tax relief to business is important for creating a vibrant economy, and that continued investments in parts of the city other than downtown. She said that there are issues that Commissioners and others have disagreed about, and that there are elements in the packages that she doesn't like, but said that in terms of the general direction, there is a good balance in investment in citizens and investments in the economy.

Mr. Brunori asked whether the Commission is going to vote on individual items or on a whole package the next week.

Mr. Williams said that the Commission would probably vote on individual items and arrive at a package that would be refined by the staff depending on the Commissioner's opinions, to be voted on in the next meeting.

Mr. Rosenthal said that the process is typically to vote on the large packages, and if individuals want to make adjustments, they must suggest offsets.

Mr. Brunori said that he is not sure whether the Commission would have trouble accomplishing what both Mr. Lazere and Mr. Tucker were arguing for with a rate of 8.5%. Mr. Brunori remarked that Mr. Ein is right about the importance of perception. He said that if D.C. has a reputation of being a high-tax jurisdiction, it will attract and retain fewer wealthy people.

Mr. Williams said that the only people surveyed about whether they support a tax increase were people who are in a self-selected group that has decided to live in D.C. despite the already high tax rate. He ended by saying that these people naturally don't mind high taxes.

Mr. Lazere responded by pointing out that the rate is the same in D.C. as it is in as in Maryland. He said that the real problem that the Commission should focus on the fact that D.C. taxes the poor at a rate that is way too high.

Mr. Brunori said that a levy on services fee on employees is something that no one does, because the one thing you don't want to have is a tax on employees, especially because this would not tax federal or District employees.

Mr. Ein said that he hopes that there is a compromise, and that sometimes the best moves come at the very end. He added that there are other ways besides hiking the rates at the top to fund lower fixed rates.

Ms. Reuben added that lowering the rate to 8.5% to 6.5% at middle-income levels costs lots of money because it is a tax that everyone is paying. She said that she would prefer to have a straight top rate increase instead of an itemized deduction phase out. She added that part of the reason for lowering the estate tax was to send a signal to wealthy people. She remarked that she was a little confused about the incidence of the commercial property tax rates, and concerned about who gets that benefit. She asked whether it also benefits business owners in D.C. that are renting, and whether owners of buildings that are not located in D.C. will benefit.

Ms. Whiteman said that the bifurcated rate in the first place was driven by a desire to help small businesses, which included lowering the rate on the first \$3 million of value. She added that this

affects what you are paying by leasing, but that it is one of the many things people consider in terms of whether people are going to lease or not.

Mr. Fitzroy Lee asked why Ms. Reuben prefers a higher rate to a phase out.

Ms. Reuben said that phase outs are less honest than higher rates.

Mr. Lee pointed out that the itemized deduction phase out results in a broadening of the base, because the point is that at higher incomes, there is some sheltering that is not available to people at the lower end of the scale.

Mr. Brunori agreed with Mr. Lee's assertions. He remarked that the phase out is a way of broadening the base at the higher income levels, and that this is a compromise that he was thinking of, between Mr. Lazere and Mr. Ein's perspectives on the income tax rates.

Ms. Reuben said that if the Commission is not changing anything else at the top, she would be worried that it is penalizing middle-income singles. She said that if the Commission gets rid of the 8.95% rate, then married couples are paying the top rate at \$80,000 and singles at \$60,000.

Mr. Williams cautioned that the Commission not allow perfect be the enemy of the good.

Mr. Lazere asked to make a few points. First, on the issue of signaling on the income tax, he argued that if the Commission gets rid of the 8.95% top rate that this would send a bad signal with respect to progressivity. Second, Mr. Lazere said that he does not understand or support the idea of dedicating the local service levy because the Commission should not be instructing the D.C. Council on how to spend money. Third, he said that the business franchise tax cut sends a strong signal, as does the estate tax threshold. He noted that the Commission heard consistently that the business franchise tax, and not the commercial property tax is the biggest issue in D.C. He said that he believes that the Commission need only send one business signal. He said that the commercial property tax cut in either package does not have strong support. Fourth, Mr. Lazere said that the Urban Institute reported to the Commission that reducing the business franchise tax rate would not create much positive economic change. He added that the nature of the marketplace in the district is that the franchise tax makes up a small percentage of the total tax burden, and is unlikely to encourage much activity that would not otherwise take place. He said that D.C. beat all its neighbors in growth of business and wages for the past several years.

Mr. Williams said that the growth compared to neighbors is softer than one might think, because it is growth from a very low base line. He added that 15 years ago there was not much growth at all, so any kind of growth would out pace D.C.'s rivals. He went on to note that it is profoundly important that D.C. diversify its business base in light of the federal retrenchment, and that D.C.

cannot take its economic status composition for granted. Mr. Williams also said that the Commission cannot talk about taxes without talking about a budget, and that discussing a financial plan is necessary, since one of the reasons there is discussion about a surplus is that D.C. has had limits on what the government can do and they have worked well.

Mr. Lazere said that the Commission needs to make the tough decisions.

Ms. Whiteman said that the Commission should aim for bold changes, implemented in a way that fairly balances the need to address those at lower income levels, while building reserve for the future. She added that it is also important to attract more residents by sending a signal with the estate tax and the commercial property tax rate.

Mr. Ein agreed with Mayor Williams, pointing out that you cannot underestimate what is happening in Washington and the broader economy. He said commercial vacancy rates had been increasing in the city. Mr. Ein added that he enjoyed working with the Commission, and that they all were put on the Commission because each has ideas about how to best improve the city. He said that having the Commission's recommendations withstand the test of time is important to him, and that the Commission should think in terms of a road map that the commissioners can all be proud of.

Mr. Lazere said that the research presented to the Commission should count for more than personal anecdotes.

V. Commission Business

Mr. Widdicombe said that the Commission will next meet on Monday, Dec. 9.

Mr. Widdicombe promised to present the Commission with a list of tax administration options before that meeting. Ms. Whiteman noted that after some study she was encouraged by the proposal to create a tax court in D.C. if it were similar to the system in Maryland.

VI. Adjournment

Mr. Williams announced that the meeting was adjourned at 5:00 p.m.